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# United States Foreign Banking and Investment Opportunities: Branching out to the Russian Federation

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# United States Foreign Banking and Investment Opportunities: Branching Out to the Russian Federation

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## I. INTRODUCTION

Financial opportunities for the West have materialized with the collapse of the former Soviet Union and its Eastern European neighbors.<sup>1</sup> A profoundly different political and economic climate has emerged since the demise of the Congress of People's Deputies on October 4, 1989, and the election of the new Federal Assembly on December 12, 1989.<sup>2</sup> The Russian Federation, subject to the decline of centralized control, has not yet learned the lessons of market economics and capitalism.<sup>3</sup> U.S. banks may help the Russian Federation learn the lessons of a market economy and may profit abroad by providing services to U.S. businesses and others in the Russian Federation.<sup>4</sup>

During the Cold War, the United States and the former Soviet Union practiced forty-five years of political and economic containment.<sup>5</sup> Having seen the collapse of communism in the former Soviet Union, the United States has strong practical and moral reasons to provide economic and political leadership to the Russian Federation and Eastern Europe; if the area reverts back to communist rule, economic and political tensions could re-emerge.<sup>6</sup>

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1. See David E. Birenbaum, *Business Ventures in Eastern Europe and Russia*, vol. I, § 2.02[a] (1994) (discussing private investment opportunities in the Russian Federation). The Russian Federation contains an abundance of natural resources including oil and natural gas, and also includes a huge domestic market. *Id.* See generally U.S. Dept. of State, *Feature: Doing Business in the New Independent States*, DEPT. OF STATE DISPATCH, July 25, 1994, at 1 [hereinafter DISPATCH] (discussing business opportunities in the New Independent States of the former Soviet Union which includes the Russian Federation). Support is needed for the newly structured market of private institutions including insurance, banking and financial markets. *Id.* John Edwin Mroz, *Russia and Eastern Europe: Will the West Let Them Fail?*, 72 FOREIGN AFF. 44 (1993) (advocating U. S. participation in the Russian Federation's emergence into a market economy).

2. See Birenbaum, *supra* note 1, § 2.01 (discussing how the legal regime governing foreign investment has been in constant flux since the late 1980s and how much uncertainty still remains); see also Dimitri Simes, *The Return of Russian History*, 73 FOREIGN AFF. 67 (1994) (discussing the importance of continued progress and the serious implications for the U.S. if the Russian-Soviet empire is allowed to re-emerge); Ned Hill & Sviatoslav Slavinski, *The Emergence of Commercial Banking in Russia*, 14 TMA J. 36 (1994), available in WESTLAW, Acct&Tx Database. After 70 years of Communist domination, the Russian Federation is now moving towards democracy and free market economy. *Id.*

3. See Hill & Slavinski, *supra* note 2, at 43 (analyzing the urgent need for advice and services of U.S. banks to guide the newly created Russian Federation commercial banks); TRADE & COMMERCIAL LAWS OF THE RUSSIAN FEDERATION: OFFICIAL CODIFICATION WITH COMMENTARY iv (1993) [hereinafter COMMERCIAL LAWS]. The main task of the Russian Federation government is to create a legal foundation which will ensure that the entire economy is supported by respective legal regulations. *Id.* at xiii.

4. See Birenbaum, *supra* note 1, § 2.02[a] (recognizing financial opportunities for foreigners in the Russian Federation even though there are legal and political uncertainties). Over 2000 Russian Federation joint ventures were in operation as of June 1992 with start up capital of foreign investors exceeding US\$1 billion. *Id.* With half of these as manufacturing joint ventures, many of which are U.S. manufacturers such as General Motors, there is a need for U.S. banks to accommodate U.S. businesses overseas. *Id.*

5. Mroz, *supra* note 1, at 44.

6. The best way to normalize relations between the U.S. and the Russian Federation is to remove cold-war trade and investment restrictions by negotiating a network of economic agreements. U.S. Dept. of State, *supra* note 1, at 4. See Mroz, *supra* note 1, at 44-45 (discussing the importance of favorable economic relations between the United States and the Russian Federation and asserting the premise that the United States has a

A transformation began in the late 1980s when Soviet President Mikhail Gorbachev initiated *perestroika*.<sup>7</sup> This reform program recognized the need for the Soviet Union to change its economy in the midst of a stagnating centralized economy.<sup>8</sup> The collapse of the centralized government precipitated the formation of independent countries,<sup>9</sup> many of which strive toward a market economy modeled after the West.

The financial and economic stability of a country relies heavily on its banking system.<sup>10</sup> There is a need for U.S. investment in the Russian Federation banking system because it does not yet have a reliable monetary system in full force.<sup>11</sup> This comment provides a guide for practitioners and bankers who seek foreign banking investment opportunity in the Russian Federation. It outlines the Russian Federation's need for an effective, efficient and profitable monetary system. This comment also explores the apparent opportunity for U.S. banks to open branches in the Russian Federation.<sup>12</sup> Part II discusses the need for a banking structure in the Russian Federation and why there is a good investment opportunity for U.S. banks to open branches in the Russian Federation.<sup>13</sup> Part III sets forth how a U.S. bank can establish a branch in the Russian Federation and legal hurdles it must overcome in both the United States and the Russian Federation.<sup>14</sup> Part IV discusses how the political climate in the Russian Federation presents potential legal problems but recommends that practitioners, bankers, and investors take advantage of investment opportunities and the chance to aid the newly created

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geostrategic interest in promoting economic stability in the Russian Federation); U.S. Dept. of State, *supra* note 1, at 4 (describing the importance of U.S. government initiative to encourage U.S. economic guidance in the Russian Federation). The United States is working to support Russian Federation integration into a market economy by removing restrictions on trade and investment and by negotiating a network of economic agreements to support economic cooperation. *Id.* "An investment in Russia's democratic future is an essential investment in America's future as well." *Id.*

7. See MIKHAIL GORBACHEV, *PERESTROIKA* 49-55 (1987). *Perestroika*, which means restructuring, signified economic reformation and restructuring as a response to exhausted resources under the centralized government of the Soviet Union. *Id.* at 9-11; Birenbaum, *supra* note 1, § 2.03[a]. The evolution of foreign investment began in the mid-1980s with *perestroika*. *Id.* The goal was to integrate foreign investment into the Soviet, now the Russian Federation, economic and legal systems. *Id.*

8. See generally GORBACHEV, *supra* note 7, at 45-49 (discussing the changing times in the Soviet Union and the need for reform).

9. See generally Mroz, *supra* note 1, at 44 (describing the implications of a newly forming market economy in the Russian Federation and Eastern Europe).

10. See Hill & Slavinski, *supra* note 2, at 1 (recognizing the Russian Federation's move towards private enterprise, especially in the area of commercial banking, as a necessity for a stable economy).

11. *Id.* (setting forth the Russian Federation's transition to a free market economy). After 70 years of Communist domination, the Russian Federation is attempting to create an economy based upon private ownership and enterprise by recreating its legal and economic systems. *Id.* at 36. See also Birenbaum, *supra* note 1, § 2.01. Legal instability plagues the Russian Federation because of gaps in the law, poor reporting systems, and a complex bureaucracy still in place. *Id.*

12. See *supra* notes 1-11 and *infra* notes 13-15 and accompanying text.

13. See *infra* notes 16-69 and accompanying text.

14. See *infra* notes 70-162 and accompanying text.

market economy in the Russian Federation.<sup>15</sup>

## II. THE NEED FOR A STRONG BANKING SYSTEM IN THE RUSSIAN FEDERATION

The Russian Federation banking system is underdeveloped in that it lacks the degree of competition and regulation that healthy bank models provide.<sup>16</sup> Now, a new independent and privatized Russian Federation attempts to reshape the banking structure which existed before the collapse of the Soviet Union.<sup>17</sup> Government leaders recognize the critical need to reorganize and reassess the nation's highly inefficient banking system.<sup>18</sup> The Russian Federation indicates that it is willing to initiate economic reform initiatives that reflect Western standards.<sup>19</sup>

A stable and efficient economy requires a central bank to guide a profitable commercial banking system, accompanied by many branches to hold the nation's wealth, control inflation with interest rates, and infuse the economy with lending.<sup>20</sup> The process of commercialization involves independent management of resources and structuring of portfolios.<sup>21</sup>

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15. See *infra* notes 163-186 and accompanying text.

16. See *supra* notes 8-11 (discussing the Russian Federation's impediments in its attempt to create a market economy); see also David Rudnick, *First Sort Out The Banks*, 299 EUROMONEY 157 (1994) (describing the presently handicapped system of banking in the Russian Federation and the need to create a modern banking system).

17. Mikhail Lapidus & Michael D. Corbin, *Banks and the Free Market in the Former Soviet Union*, 96 NAT'L ASSOC. OF CREDIT MGMT. BUS. CREDIT 25 (1994). As a result of *perestroika*, the first commercial banks in the Russian Federation appeared; within six months there were 1500 commercial banks and by 1994 there were 3000 commercial banks. *Id.* In the Russian Federation there is only one bank per 50,000-60,000 residents, compared to the United States which has one bank per 5000 residents. *Id.* There is a great need for an expanded banking system. *Id.* See Rudnick, *supra* note 16, at 157 (discussing the establishment of a stable and efficient banking structure as the backbone of a sound economy).

18. See William Pesek Jr., *Russia Taps U.S. Experts to Overhaul Funds Transfer System*, AM. BANKER, Apr. 2, 1993, at 3, available in LEXIS, News Library, Ambank File (describing how the Russian Federation is absorbing U.S. banking knowledge); *Yeltsin Eases Curbs on Foreign Banks; Russia Set to Sign EU Partnership Pact*, Banking Daily (BNA), June 13, 1994, available in WESTLAW, Bna-bbd Database. Russian Federation President Yeltsin stated in a news conference that a decree 'On Perfecting the Operation of the Banking System of the Russian Federation' would encourage competition among Russian Federation banks and foreigners, as well as attract foreign investment which will infuse the Russian Federation economy with much needed capital. *Id.*

19. See Richard Boudreaux, *Yeltsin Vows to Stand by Tight Budget*, SAC. BEE, Nov. 27, 1994, at A15. In order to achieve financial stability, Yeltsin forbade the central bank from printing rubles to cover shortfalls. *Id.*

20. See generally G. YAVLINSKY ET AL., 500 DAYS TRANSITION TO THE MARKET 71-73 (1991) (setting forth the proposition that without a stable currency, it is impossible to stabilize the economic structure). *Governing Activities of Foreign Banks*, Banking Daily (BNA), July 23, 1993, available in WESTLAW, Bna-bbd Database. A chairman of the Central Bank endorsed the expansion of foreign banks in the Russian Federation because it will "facilitate investments in the economy and create the necessary competitive environment that will meet the needs of Russian clients." *Id.*

21. See G. YAVLINSKY ET AL., *supra* note 20, at 72.

There is a great need for investment capital in the Russian Federation banking system to stimulate the emerging free market.<sup>22</sup> The presence of fully operational banks in the Russian Federation will facilitate the flow of foreign investment by making loans to venturers and providing a facility for savings and investment.<sup>23</sup> Russian Federation banks currently lack sufficient capital to finance large-scale investment projects which foreign branches can offer.<sup>24</sup>

More specifically, U.S. banks are needed in the Russian Federation to supply capital and alleviate technical deficiencies. In the past, slow payment clearing and account transfers, as well as poor service and inexperienced personnel, discouraged foreign investment in Russian banks.<sup>25</sup> Therefore, establishment of foreign branches of U.S. banks may also attract foreign investment because in other areas U.S. investors are more familiar with the U.S. banking standards and are more comfortable dealing with U.S. branches in the Russian Federation.<sup>26</sup>

#### A. *Infusion of a Market Economy Based Monetary System*

To provide sound advice and guidance to those who wish to engage in banking in the Russian Federation, the practitioner must understand the need of the Russian Federation for a market-based monetary system, as well as the Russian Federation monetary system, from an historical perspective.<sup>27</sup> U.S. banks first extended operations overseas in the early part of the century when merchants provided war materials in foreign countries.<sup>28</sup> Now, banks follow U.S. industries

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22. See *infra* notes 24-26 and accompanying text (discussing the need for foreign investment capital).

23. *New Opportunities Emerging For Foreign Banks in Russia*, Banking Daily (BNA), Feb. 25, 1993, available in WESTLAW, Bna-bbd Database. *Higher Capital Requirements Strengthen Russia's Banking System*, COMMERSANT, Mar. 7, 1994, at 4, available in WESTLAW, Pts-prompt Database. One way in which Russian Federation banks will become fully operational and competent is by imposing high capital requirements. *Id.*

24. See *infra* note 71 and accompanying text (discussing large-scale investment projects in the Russian Federation which were financed by foreigners).

25. *Id.*; see *Russia: New Clearing Center Will Serve Moscow Banks*, COMMERSANT, Feb. 25, 1994, available in WESTLAW, Pts-prompt Database (indicating that a fourth clearing center was recently established and more are expected to facilitate new commercial banks and expedite the system); *Commercial Banks on the Rise*, FIN. E. EUR., July 1, 1994, available in WESTLAW, Pts-prompt Database (discussing the need to filter out unprofitable banks).

26. See *Free Market Economy Prevailing in Russia—Through the Help of ATMs*, NEWS RELEASE, Apr. 6, 1994, available in WESTLAW, Pts-prompt Database. Recently, the largest insurance company in Russia purchased automated teller machines (ATMs) from a joint venture involving International Business Machines Corporation (IBM). *Id.* The ATMs will dispense rubles off-line through the use of smart cards. *Id.* The purchase and installation of the ATMs is a significant breakthrough for the Russian Federation banking system. *Id.*

27. See *infra* notes 28-69 and accompanying text (discussing the infusion of a market based monetary system in the Russian Federation and the history of its monetary system).

28. See Michael P. Malloy, *Bumper Cars: Themes of Convergence In International Regulation*, 60 FORDHAM L. REV. S12 (1992) (describing the historical roots of U.S. international banking during World War I). U.S. banking overseas traces to the early twentieth century during World War I. *Id.* at S14.

and operations to countries all over the world.<sup>29</sup> The Russian Federation is a new source of economic productivity and investment into which U.S. banks and businesses should venture.

Russian Federation venturers are willing to accept Western investment in order to obtain capital and management guidance.<sup>30</sup> For example, the Russian Federation Central Bank called on U.S. electronic banking expertise to facilitate the way it handles corporate and consumer matters.<sup>31</sup>

The need for guidance is exemplified by the fact that the U.S. Federal Reserve and major commercial banks established an advisory group known as the Russian-American Bankers Forum.<sup>32</sup> This group will reform and revitalize the Russian Federation banking structure and assist in converting the economy to a market-based system by sharing information.<sup>33</sup> Drafting recommendations is the group's main task;<sup>34</sup> but, the group also provides badly needed technical assistance.<sup>35</sup> The recommendations cover the development of (1) retail banking and payment services; (2) an interbank market with a system for large-value, third party payments; and (3) a market for government securities.<sup>36</sup>

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29. *Id.* at \$15. After peaking at US\$453.8 million, U.S. investment in the Russian Federation dropped to US\$233.5 million in 1991; however, foreign investment in the Russian Federation has superseded the other former Soviet Republics. Birenbaum, *supra* note 1, § 2.02[a]. In March and April 1993, 213 new enterprises with foreign investments were registered in the Russian Federation and 42% were wholly owned by foreign investors. Maxim Balashov, *No Lull in Foreign Business Investment*, COMMERSANT, Apr. 7, 1993, at 9; Dmitry Romoanov, *New Firms With Foreign Participation*, COMMERSANT, May 5, 1993, at 9; see Irina Ilyukhina, *Chaos Aside, Western Investors Optimistic About Opportunities in CIS Markets*, COMMERSANT, Nov. 3, 1992, at 9.

30. See Steven Prokesch, *A Soviet Bank Takes Up Capitalism*, N.Y. TIMES, Oct. 7, 1990, § 3, at 8 (detailing the willingness of a particular Soviet investment bank to corroborate with Western banks or accounting firms which would help the Soviet Union turn state-owned enterprises into investor owned companies).

31. See Pesek, *supra* note 18, at 3. The central bank enlisted the help of the National Automated Clearing House Association and a Washington, D.C. based international bank consulting and marketing firm to help it design a replacement for an outdated electronic funds transfer system currently in use. *Id.*; see *Contract Brings Western Banking Equipment to Russia*, OFFICE EQUIPMENT & PRODUCTS, May 1994, available in WESTLAW, Pts-prompt Database (stating that the Savings Bank of the Russian Federation obtained computers and other technical equipment from a U.S. corporation). Unisys, which was recently awarded a US\$127 million contract from the Savings Bank, will also instruct the Russian Federation in Western banking methods. *Id.*

32. See James R. Kraus, *Fed, U.S. Bankers Plan Assistance for Russia*, AM. BANKER, June 22, 1992, at 1, available in LEXIS, News Library, Ambank File (setting forth a plan established by a group of prominent U.S. bankers to assist the Russian Federation).

33. *Id.*

34. *Id.*

35. *Id.* The Russian Federation-American Bankers Forum is extraordinary because U.S. participation in an overseas economic advisory program is rare. *Id.*

36. *Id.* (setting forth a banker's plan established by a group of prominent U.S. bankers to assist the Russian Federation by making recommendations for a financial system that is more sound). The 17 U.S. members include senior Federal Reserve officials and executives from some of the biggest U.S. banks and law firms. *Id.*

Cooperation from both countries seems hopeful as shown by the fact that the Russian Federation government and the United States government have jointly established the Russian Banking Forum (Forum) to facilitate the flow of U.S. private capital into the Russian Federation.<sup>37</sup> As a result of the Forum, many U.S. banks have developed and assisted businesses in Russia.<sup>38</sup>

## B. The Russian Federation Banking System

The banking system under the newly established Russian Federation consists of the government and private banks. The three semi-government entities are: (1) the Bank of Russia (also known as the Central Bank); (2) the Bank of Foreign Trade of the USSR (*Vnesheconombank*); and (3) the Savings Bank.<sup>39</sup> However, the practitioner may find it useful to comprehend where the banking structure came from in order to predict its stability as the new banking system today and in the future.

### 1. Centralization Under the Soviet Union

After the 1917 Bolshevik Revolution,<sup>40</sup> the communist government emerged under the leadership of Lenin, and a socialist economy was established based on the notions of socialism.<sup>41</sup> From the beginning, the socialist economy introduced monetary and price controls along with an artificially created market. Eventually, this led to economic stagnation and negative growth.<sup>42</sup> However, banking still had

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37. *Id.* Russian Federation officials said that they are seeking to form a privately run Russian Federation-American Investment bank to facilitate the flow of private U.S. capital into the Russian Federation. *Id.*

38. *Id.* (discussing how U.S. banks are already participating in the Russian Federation market by starting and assisting businesses). Bankers Trust is already acting as an advisor to the Russian Federation's state-owned natural gas company. *Id.* Chase Manhattan and Bank of New York supply the Russian Federation commercial banks with money transfers, cash management, letters of credit and information services. *Id.*; see David O. Tyson, *American Express to Install USSR's First ATMs*, AM. BANKER, June 17, 1988, at 7, available in LEXIS, News Library, Ambank File. In 1988, American Express signed a joint venture agreement with the Bank for Foreign Economic Affairs of the U.S.S.R. to set up ATMs which dispensed travelers cheques and Soviet 10-ruble notes at 18 different branches in Moscow and Leningrad. *Id.*

39. *Commentary: The Russian Banking System*, in COMMERCIAL LAWS, *supra* note 3, at 40. The Bank of Russia acts as both the central bank of the Russian Federation and the principal regulator of private, commercial banks. *Id.* The Bank of Foreign Trade will handle external debt including the issuance of government bonds and manage the assets of the former Soviet Union. *Id.* at 40-41. The Savings Bank is established on a joint stock basis with the Bank of Russia as its primary shareholder. *Id.* at 41. As of June 1, 1993, there were 2214 commercial banks. *Commercial Banks on the Rise*, FIN. E. EUR., July 1, 1994, available in WESTLAW, Pts-prompt Database.

40. See GEOFFREY HOSKING, *THE FIRST SOCIALIST SOCIETY* 33-56 (1992) (discussing the overthrow of the tsarist monarchy and the beginning rule of Marxist revolutionaries).

41. *Id.*

42. See Rudnick, *supra* note 16, at 157. Banks under the Soviet Union were subsidized and loaned money off-budget to state enterprises. *Id.*



a place in the economy and Russia's first cooperative bank established a London agency which incorporated as a British bank in 1919.<sup>43</sup> Two years after the Russian Revolution, the cooperative bank helped finance trade between the Soviet Union and Great Britain.<sup>44</sup> Although this bank also helped the Soviet Union with foreign exchange, trade finance remained its primary mission until the late 1980s.<sup>45</sup> Until recently, *Gosbank* (State Bank)<sup>46</sup> of the Soviet Union was the country's central bank and the main commercial bank.<sup>47</sup> *Vneshtorgbank* (Foreign Trade Bank)<sup>48</sup> oversaw, and often financially guaranteed, the Soviet Union's commercial dealings with the outside world.<sup>49</sup> There were also savings banks, organized under the State Bank which performed a personal savings function.<sup>50</sup> However, the State Bank and Foreign Trade Bank were the two main banking entities and had a monopoly over the entire banking system.<sup>51</sup>

The banking structure under the former Soviet Union was simplified so that banks did not compete with each other; all commercial banks were branches of the State Bank.<sup>52</sup> Banks handled most financial dealings of 100 rubles or more.<sup>53</sup> A financial clearing house<sup>54</sup> processed all the commercial bank transactions and the entire system operated on the basis of bookkeeping deductions.<sup>55</sup> Therefore, the State Bank had the authority to supervise the credit relations of the state's eco-

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43. See Prokesch, *supra* note 30, § 3, at 8 (tracing the history of a Moscow investment bank, which originated from a Russian bank and established a branch in Russia to facilitate trade between the Soviet Union and Britain).

44. *Id.*

45. *Id.*

46. 1 ENCYCLOPEDIA OF SOVIET LAW 76 (1973). *Gosbank* was the central bank of the USSR. *Id.* It issued bank notes and made sure that funds which it loaned were used in compliance with the financial policy of the U.S.S.R. government. *Id.*

47. See Prokesch, *supra* note 30, at 8 (detailing the history of Soviet banking).

48. The Foreign Trade Bank dealt with foreign trade finance in the U.S.S.R.. 1 ENCYCLOPEDIA OF SOVIET LAW 76, 77 (1973). It signed agreements with foreign banks relating to large scale financial transactions. *Id.*

49. See Prokesch, *supra* note 30, at 8 (detailing the history of Soviet banking).

50. 1 ENCYCLOPEDIA OF SOVIET LAW 77 (1973).

51. Christopher Nightingale & Dr. Stephen Tupper, *Foreign Trade Organization in the U.S.S.R.*, in RUSSIAN AND SOVIET ECONOMIC CHANGE: THE NEW INVESTMENT LAWS, INTELLIGENCE REPORTS 9 (1991) [hereinafter REPORTS]. In the former Soviet Union, the main banks were:

(1.) *Vneshekonombank* [Bank for Foreign Economic Relations], the premier bank for foreign trade;

(2.) *Gosbank* [State Bank of the U.S.S.R.], dealing with most foreign currency transactions;

(3.) *Prom Stroiibank* [U.S.S.R. Construction Bank], dealing with construction related projects; and

(4.) *Agrobank* [U.S.S.R. Agricultural Bank] dealing with the agricultural sector.

*Id.* With privatization, these banks are no longer the only participants in the financial structure. *Id.*

52. HAROLD J. BERMAN, JUSTICE IN THE U.S.S.R.: AN INTERPRETATION OF SOVIET LAW 143 (1963).

53. *Id.*

54. A clearinghouse is a place where banks exchange checks and drafts drawn on each other and settle their daily balances. BLACK'S LAW DICTIONARY 172 (6th ed. 1990).

55. BERMAN, *supra* note 52, at 143. Double entry bookkeeping is an accounting system which requires a debit and a credit to be recorded for every transaction. BLACK'S LAW DICTIONARY 126 (6th ed. 1990).

conomic enterprises.<sup>56</sup> However, it was not so much the banking structure that led to failure of the system but rather a lack of competition within the system which prevented efficiency and productivity within the banking system.<sup>57</sup>

Bank profitability stagnated in the former Soviet Union because profitability of corporations, including banks, was not a concern to shareholders; socialism equalized the earnings of everyone and the success of a corporate entity was determined by its ability to meet quotas.<sup>58</sup> For this reason, the structure of the banking system under the former Soviet Union was economically limited.<sup>59</sup> It did not operate for profit, lacked competition, and was not akin to banks in a market economy; a stagnating and ailing economy inevitably resulted from the lack of competition among corporations, and eventually forced reform.<sup>60</sup>

## 2. Modern Attempts to Privatize

Under Gorbachev's rule in the late 1980s, *perestroika* encouraged and precipitated banking reforms.<sup>61</sup> The introduction of privatization<sup>62</sup> and deterioration of the monopolistic positions of the State Bank and Foreign Trade Bank provoked rivalry among the financial institutions in the Soviet republics.<sup>63</sup> As a result of *perestroika*, the infusion of venture capital into the economy increased the number of financial institutions which were needed to accommodate new businesses.<sup>64</sup> Commercializing the individual state banks allowed banks to handle their own affairs without the guidance of an overwhelming bureaucracy.<sup>65</sup> This

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56. BERMAN, *supra* note 52, at 143.

57. See *supra* notes 8-11 (explaining the lack of profit earning incentive in the Soviet system).

58. *Id.* (discussing the ramifications of a centralized economy where there is no incentive to be profitable because socialist economies discourage the manufacture or sales for profit).

59. See *supra* notes 42-58 and accompanying text (discussing the banking structure under the former Soviet Union).

60. See *supra* notes 8-11 and 42-58 and accompanying text (explaining the lack of profit earning incentive in the Soviet system).

61. See generally GORBACHEV, *supra* note 7 (using the notion of *perestroika*, restructuring, as the next stage in Socialist history which instigated radical alterations of foreign and domestic policies).

62. See *id.* at 84-98 (discussing economic reform in 1987 and advocating cost accounting). Full cost accounting is the notion of replacing bureaucratic administrative quota and price setting with market forces. *Id.* at 88. See also Birenbaum, *supra* note 1, § 2.02[b][4]. The privatization program is generally the sale of state assets and enterprises to private investors. *Id.* The Russian Federation Constitution states that private ownership shall be recognized and defended by the Russian Federation. COLLECTED LEGISLATION OF RUSSIA, *Constitution (Basic Law) of the Russian Federation—Russia*, ch. 2, art. 10 (1993).

63. See *supra* note 51 and accompanying text (explaining the monopolistic nature of the banking system under the former Soviet Union).

64. REPORTS, *supra* note 51, at 9.

65. See YAVLINSKY, *supra* note 20, at 72. The parliament recently enacted a law entitled "On the Central Bank of the Russian Federation" which recognizes the banking structure as independent of the government and subordinate only to the Supreme Soviet. See *Governing Activities of Foreign Banks*, *supra* note 20.

independence includes choosing placement of loans, establishing loan prices, and setting loan terms, all of which initiated transformation of the banking structure.<sup>66</sup>

The former Soviet Union's tight control of the previous banking system also extended to foreign activity within the Soviet Union. Until recently, foreign banks were severely restricted.<sup>67</sup> Now, there are over seventy-five accredited offices of foreign banks in Moscow.<sup>68</sup> However, this is only the beginning and much reform of the banking industry is needed.<sup>69</sup>

### III. ESTABLISHING UNITED STATES BANKING INSTITUTIONS IN THE RUSSIAN FEDERATION

#### A. *Investment Opportunities*

U.S. banks branching out to the Russian Federation present an excellent investment opportunity, for both the Russian Federation and the United States, because the Russian Federation needs a monetary system compatible with a free market economy, representing a new source of investment from which U.S. bankers may profit.<sup>70</sup> Currently, investment banks in the Russian Federation solicit U.S. investors who can infuse capital into the fledgling economy, as the Russian Federation tries to adapt its system to a capitalist market economy.<sup>71</sup> U.S. bankers can play an investment role by infusing capital into the economy with

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66. See *Governing Activities of Foreign Banks*, *supra* note 20. Higher capital requirements, 2 billion rubles [US\$1.27 million] for new banks, are expected to filter out nonprofitable and weak banks and will also facilitate the creation of a strong banking system. See *Higher Capital Requirements Strengthen Russia's Banking System*, *supra* note 23, at 4. The practitioner should note that the ruble exchange rate is constantly fluctuating and the capital requirement will fluctuate with the ruble.

67. See *New Opportunities Emerging For Foreign Banks in Russia*, *supra* note 23. Three U.S. banks which have representative offices in Moscow are Chase Manhattan, Citibank, and Bank of America. *Id.* These offices primarily act as facilitators for their home offices as well as providing them with information on the Russian Federation marketplace. *Id.* Accredited offices may not engage in traditional income-earning or banking activities, and cannot sign contracts in their own names. *Id.*

68. *Id.*

69. *Id.*

70. See *supra* notes 16-26 (discussing the need for a strong banking system in the Russian Federation based upon a free market model).

71. See *DISPATCH*, *supra* note 1, at 1 (providing a resource guide for U.S. businesses seeking market opportunities in the New Independent States, including the Russian Federation); Prokesch, *supra* note 31, § 3, at 8 (emphasizing the Soviet Union's attempt to become a market economy and discussing its desire for Western guidance). In 1990, Moscow Narodny Bank Ltd. helped arrange Western financing for Soviet capitalist projects such as a U.S. cosmetics shop in Moscow; modernization and expansion of polyethylene plants whose output was to be sold in the West; a furniture factory involving Finnish companies and banks; a hotel; an airport in Moscow involving French and Belgian companies, also involving banks and a Soviet airline; and a joint venture with a U.K. company to make commercial vans. *Id.*

loans, and by providing services to U.S. corporations, either establishing a bank branch, Edge branch, or Edge subsidiary.<sup>72</sup>

### 1. United States Bank Branches

The Federal Reserve Act allows national and state banks, which are members of the Federal Reserve System (Fed), to establish foreign branches.<sup>73</sup> Any Fed member bank that has a capital surplus in excess of one million U.S. dollars may establish a foreign branch, subject to the approval of the Fed.<sup>74</sup> State banks which are not members of the Fed may apply to the Federal Deposit Insurance Corporation (FDIC) for permission to operate branches abroad; however FDIC requirements and regulations model the Fed.<sup>75</sup> Regulation K, promulgated by the Board of Governors of the Fed, is the fundamental instrument which regulates all international operations of U.S. banking organizations.<sup>76</sup> Regulation K allows its members overseas to exercise general banking powers, which banks may engage in domestically, and engage in other activities the Fed determines "are usual in connection with the transaction of the business of banking in the places where the member bank's branches transact business."<sup>77</sup>

Regulation K lists fifteen activities that "are usual in connection with the transaction of the business of banking in the places where the member bank's branches transact business."<sup>78</sup> Most activities permissible under the laws of the

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72. For the purposes of this comment, "bank branch" refers to a branch which is operated by domestic banks either directly or indirectly through foreign bank ownership. See *infra* notes 74-79 and accompanying text. "Edge branch" refers to the Edge Act corporation branch, which is subject to the same regulations as a bank branch. See *infra* note 81-91 and accompanying text. "Edge subsidiaries" refers to foreign financial institutions that engage in the business of banking, are subject to the same regulations as bank and edge branches, and are owned by Edge corporations in the United States. See *infra* notes 81-91 and accompanying text.

73. 12 U.S.C. § 601 (1992). Any national bank with capital and surplus in excess of US\$1 million may file an application with the Federal Reserve Board to establish branches in foreign countries. *Id.*

74. The Federal Reserve Board is the governing body of the Federal Reserve System. 12 U.S.C. § 601 (1992). Foreign branches may be established by a bank, Edge corporation, an Agreement corporation or a subsidiary held pursuant to this sub-part. 12 C.F.R. § 211.3(a)(1) (1994). See *infra* notes 81-91 and accompanying text (discussing Edge corporations).

75. See *infra* notes 123-133 and accompanying text (discussing the role of the FDIC in international banking).

76. 12 C.F.R. § 211.1(b) (1994). The purpose of this sub-part is to set forth the rules governing the international and foreign activities of U.S. banking organizations. *Id.* See also Frank Puleo, *International Banking Developments*, 639 PRACTICING L. INST. 233 (1989) (discussing U.S. statutory provisions which govern international banking).

77. 12 C.F.R. § 211.3(b)(10) (1994). Branches promulgated under this section theoretically have leverage to engage in activities, other than those engaged in domestically, which are "usual in connection with the transaction of the business of banking in places where the member bank's branches transact business." *Id.*

78. *Id.* § 211.5(d). Permissible activities that follow activities in the usual course of banking include: (1) commercial and other banking activities; (2) financing, including commercial financing, consumer financing, mortgage banking, and factoring; (3) leasing real or personal property, or acting as agent, broker, or advisor in leasing real or personal property, if the lease serves as the functional equivalent of credit to the lessee

Russian Federation are also authorized by Regulation K, but some, like acquiring and selling precious metals, gems, and jewelry, may not be permissible banking activities.<sup>79</sup> The benefits of doing business in the Russian Federation as a branch include the prestige and perception of security associated with bank branches as well as potential assurance<sup>80</sup> by the Federal Deposit Insurance Corporation.

## *2. Edge Act Corporations*

Another way in which U.S. banks may participate in the Russian Federation monetary system is by the establishment of an Edge corporation under section 25(a) of the Federal Reserve Act.<sup>81</sup> Edge corporations are domestic corporations which confine their activities to international banking, either through branches or subsidiaries.<sup>82</sup>

The Edge Act allows U.S. corporations to operate foreign branches and subsidiaries engaged in banking activities under the direction of the Fed and subject to Regulation K.<sup>83</sup> Edge branches and subsidiaries are subject to the same require-

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of the property; (4) acting as a fiduciary; (5) underwriting credit life insurance and credit accident and health insurance; (6) performing services for other direct or indirect operations of a U.S. banking organization, including representative functions, sale of long-term debt, name saving, and holding assets acquired to prevent loss on a debt previously contracted in good faith; (7) holding the premises of a branch of an Edge corporation or member bank or the premises of a direct or indirect subsidiary, or holding or leasing the residence of an officer or employee of a branch or subsidiary; (8) providing investment, financial, or economic advisory services; (9) general insurance agency and brokerage; (10) data processing; (11) organizing, sponsoring, and managing a mutual fund if the fund's shares are not sold or distributed in the United States or to U.S. residents and the fund does not exercise managerial control over the firms in which it invests; (12) performing management consulting services provided that such services when rendered with respect to the U.S. market shall be restricted to the initial entry; (13) underwriting, distributing and dealing in debt securities outside the U.S.; (14) operating a travel agency provided that the travel agency is operated in connection with financial services offered abroad by the investor or others; and (15) engaging in other activities that the Board has determined are usual in connection with the transaction of the business of banking or other financial operations abroad and are consistent with the Federal Reserve Act. *Id.* See also Puleo, *supra* note 76, at 233 (discussing U.S. statutory provisions which govern international banking); *cf.* 12 U.S.C. § 24 (1992) (restricting activities in which domestic branches may engage).

79. 12 C.F.R. § 211.5(d)(3) (1994) (permitting foreign branches to lease property); *id.* at (d)(9) (authorizing foreign branches to act as general insurance agents and brokers); *id.* at (d)(13) (allowing foreign banks to underwrite, distribute and deal in debt securities outside the United States); *id.* at (d)(14) (permitting foreign branches to underwrite, distribute and deal in securities outside the United States).

80. See *infra* notes 124-126 and accompanying text.

81. See 12 U.S.C. § 611 (1992) (authorizing five or more U.S. citizens to organize a corporation in the United States for the purpose of engaging in foreign banking financial operations). This is known as the Edge Act. *Id.* The corporations are informally known as Edge or investment Edge corporations. *Id.* Most of these corporations are owned by banks. William B. Glidden, *The Regulation Of U.S. Banks' Operations Abroad*, 108 *BANKING L.J.* 110 (1991).

82. 12 U.S.C. § 615 (b)-(c) (1992).

83. *Id.* Corporations may organize for the purpose of engaging in foreign banking by establishing branches or subsidiaries abroad. *Id.* Regulation K governs the international and foreign activities of U.S. banking organizations, including procedures for establishing foreign bank branches, Edge branches, and Edge subsidiaries to engage in international banking. *Id.* § 211.1(b).

ments as bank branches when engaged in banking operations.<sup>84</sup> Edge branches and subsidiaries differ from bank branches because they permit businesses other than banks to open a bank abroad but operate the bank in the United States.<sup>85</sup> Edge corporations may invest fifteen percent of capital in any one foreign subsidiary engaged in the business of banking.<sup>86</sup>

Edge branches and subsidiaries are beneficial because they allow a U.S. state nonmember bank<sup>87</sup> to have branches and subsidiaries in foreign countries where

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84. *Id.* § 615. Edge corporations may deal in drafts, bills of exchange and other evidences of indebtedness; the purchase and sale of securities; letters of credit; borrowing and lending; deposits, etc.. *Id.*; JONATHAN R. MACEY & GEOFFREY P. MILLER, *BANKING LAW AND REGULATION* 709 (1992). It is important for the practitioner to note that Edge corporations may also be more beneficial than actual bank branches because the Central Bank of Russia favors subsidiaries over branches. Robert Langer, *Foreign Banking in the Russian Market*, 61 *Banking Rep. (BNA)* 541, Oct. 4, 1993, available in WESTLAW, Bna-bnk Database. Usually the Central Bank will only grant limited bank licenses, which restrict operations to non-residents, to bank branches and will only grant general licenses, which permit a large range of activities, to subsidiaries. *Id.*

85. See 12 C.F.R. § 211.3(b)(2) (1994) (granting general consent for investment edge corporations) [hereinafter Edge Corporations].

A foreign branch may invest in the following:

- (a) securities of the central bank, clearing houses, governmental entities, and government sponsored development banks of the foreign branch's host country;
- (b) other debt securities which the host country determines are eligible to meet local reserve requirements; and
- (c) shares in organizations like professional societies and schools which are necessary to the branch's business.

*Id.*

A foreign branch may underwrite, distribute, buy and sell obligations of the following:

- (a) the host country's national government;
- (b) an agency or instrumentality of the host country's national government; or
- (c) a municipal, local, or regional governmental entity.

*Id.*

Other activities of the foreign bank include:

- (a) taking liens or encumbrances on foreign real estate as security for loans which do not have to be senior and the land may be unimproved;
- (b) acting as an insurance agent or broker;
- (c) acting as part of an employee benefit plan, [the bank] may pay an employee a higher rate of interest than other depositors receive;
- (d) may enter repurchase agreements involving securities and commodities if the repurchase agreement is functionally equivalent to extending credit;
- (e) establish or invest wholly in owned subsidiaries which engage in permissible member bank activities, or activities incidental to the banking business in the host country [FRB must grant prior approval to these activities];
- (f) engage in other activities which are usual to the banking business in the host country, but only with prior approval from the Federal Reserve Board.

*Id.*

86. See 12 U.S.C. § 615 (c) (1992); *cf. id.* at § 84 (setting forth the lending limits of national banks). A national bank may lend up to 15% of its capital to a single borrower. *Id.*

87. See *infra* notes 123-133 and accompanying text (discussing FDIC regulation over state nonmember banks if the state law authorizes foreign banking activity).

it would not otherwise be possible, due to state law restrictions.<sup>88</sup> These corporations may take international deposits and conduct other banking functions across state lines.<sup>89</sup> Edge branches and subsidiaries may also be more advantageous than bank branches because the Russian Federation has granted more favorable banking licenses to subsidiaries than to bank branches.<sup>90</sup>

Although it is not explicit as to whether Edge branches and subsidiaries are subject to Russian Federation banking regulations in the same way that bank branches are, the language of the Russian Federation law suggests that they would be because they engage in banking and financial activities.<sup>91</sup>

### *B. Regulations Promulgated in the United States*

The practitioner must contend with dual regulations in the United States and the Russian Federation. U.S. law requires banks to follow the U.S. regulations when establishing branches abroad.<sup>92</sup> Strict adherence to U.S. regulations may also ensure economic predictability and stability both at home and in the Russian Federation.<sup>93</sup> Yet in order to accomplish the goal of economic predictability and stability, the safety and soundness concerns of U.S. banks must be addressed in the Russian context.

A number of federal and state authorities which oversee regulations in the United States that also guide U.S. banking in the Russian Federation and many of the same domestic regulations apply abroad as well.<sup>94</sup> Section 25 of the Federal Reserve Act<sup>95</sup> authorizes national banks to set up branches overseas with the

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88. Most edge corporation branches and subsidiaries are owned by U.S. banks. *See* Glidden, *supra* note 81, at 109. A bank may invest in an edge subsidiary which may invest up to 15% of its capital and surplus in a foreign company which engages in banking activities. 12 U.S.C. § 615 (c) (1992).

89. MACEY & MILLER, *supra* note 84, at 708.

90. *See infra* notes 142-154 and accompanying text (discussing the granting of general and limited licenses to foreign financial institutions in the Russian Federation).

91. *Law of the RSFSR 'On Banks and Banking Activity in the RSFSR,' in COMMERCIAL LAWS, supra* note 3, at ch. I, art. 1. The article indicates that the Russian Federation law extends to "other credit institutions" which are non-banking organizations that perform certain banking transactions. *Id.*

92. *See* MACEY & MILLER, *supra* note 84 at 708 (outlining rules and regulations for U.S. banks engaging in international activities). For example, the Federal Reserve is the primary regulator of activities and investments of branches abroad and is responsible for their establishment. 12 U.S.C. § 601 (1992).

93. *See* E.G. Corrigan, *Are Banks Special?*, FED. RESERVE BANK MINNEAPOLIS ANN. REP. 68 (1982) (explaining the importance of U.S. bank regulation to ensure bank stability).

94. MACEY & MILLER, *supra* note 84, at 708. State chartered banks must abide by state regulations and FDIC regulations if they are insured; however, federal regulations ultimately control the activities of U.S. banks abroad. 12 C.F.R. § 211.5 (1994). The Board of Governors of the Federal Reserve System sets forth permissible activities and investments abroad. *Id.*

95. The Federal Reserve Act of 1913 required national banks to become members of the Federal Reserve System. 12 U.S.C. § 221 (1992).

approval, and subject to the conditions, of the Fed.<sup>96</sup> The FDIC authorizes and regulates state chartered banks that wish to establish branches abroad.<sup>97</sup> The Comptroller of the Currency (Comptroller) monitors the capital requirements and liquidity of all branches doing business abroad.<sup>98</sup> All three entities work together to protect the financial disposition integrity of U.S. banks in foreign countries.

### 1. *The Federal Reserve System*

The Fed<sup>99</sup> plays an important role in U.S. foreign banking and serves a dual purpose of monetary guider and bank regulator.<sup>100</sup> The Fed acts as an agent in maintaining money reserves, issuing money in the form of bank notes, lending money to banks, and supervising banks.<sup>101</sup>

#### a. *Setting Monetary Policy and Ensuring Liquidity*

Domestically, the Fed lends money to the banks and acts as an inflation guider by setting the interest rate at a level at which the banks can borrow and lend money.<sup>102</sup> The Fed provides liquidity support to the parent bank of a foreign branch, which in turn provides liquidity assistance to the branch.<sup>103</sup> The Fed also ensures liquidity by discounting eligible commercial paper and making advances secured by satisfactory collateral.<sup>104</sup> These controls facilitate branch stability and

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96. *Id.* § 601 (authorizing any national banking association with capital and surplus equal to or exceeding US\$1 million to apply to the Board of Governors of the Federal Reserve System for permission to establish branches in foreign countries). If the member bank operates branches in at least two foreign countries, it may establish branches in other foreign countries by giving the Federal Reserve Board 45 days advance notice. *Id.* at (a)(3). Prior authority to establish foreign branches expires one year from the earliest date on which the authority could have been exercised unless the Federal Reserve Board expressly extends the period. *Id.* at (a)(4). Any bank which opens, closes, or relocates a foreign branch must report the change to the Federal Reserve Board. *Id.* at (a)(5).

97. *See infra* notes 123-133 (describing the role of the FDIC in international banking).

98. *See infra* notes 115-122 and accompanying text (detailing the role of the Comptroller in international banking).

99. The Federal Reserve System controls the money supply through the Open Market Committee. *See MACEY & MILLER, supra* note 84, at 60. The Fed also acts as a regulator by overseeing all member banks in the Fed as well as all the nation's bank holding companies. *Id.*

100. *See MACEY & MILLER, supra* note 84, at 60.

101. *See infra* notes 102-114 and accompanying text (discussing the multiple purposes of the Federal Reserve System).

102. *See MACEY & MILLER, supra* note 84, at 52 (explaining how the Fed provides liquidity by setting the rate at which it lends money to banks as well as by reducing the reserve ratio requirement that banks must keep on hand). The Fed manipulates the money supply, creating and destroying money by lowering and escalating the discount rate, as well as through the Open Market Committee, which buys and sells U.S. Treasury Bonds. *Id.*

103. *See MACEY & MILLER, supra* note 84, at 52.

104. 12 U.S.C. § 461(b)(2), (7) (1992) (requiring banks to maintain a certain amount of reserves against their transaction accounts, and granting them discount and borrowing privileges from the Federal Reserve).



allow lending which ultimately provide banks with profit and inject the economy with new money.<sup>105</sup>

*b. Acting as Regulator*

The Fed also regulates both national banks and U.S. state member banks seeking to establish or expand operations in foreign countries, providing uniformity in overseas presence.<sup>106</sup> Nothing in the Federal Reserve Act<sup>107</sup> indicates that state banks have a lesser opportunity than national banks to engage in foreign banking.<sup>108</sup> Both state and federal banks must apply to the Fed for permission to open a U.S. branch abroad.<sup>109</sup> The Fed rules on the national bank applications, interprets the laws of the foreign countries, establishes policies, and determines which banking activities are permitted.<sup>110</sup> Once a member bank operates branches in at least two foreign countries, it may establish branches in other foreign countries by giving the Fed forty-five days advance notice.<sup>111</sup>

The Federal Reserve Act restricts banks from engaging in certain activities such as the general business of producing or distributing goods or merchandise.<sup>112</sup> United States banks doing business abroad are allowed to engage in more

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105. See MACEY & MILLER, *supra* note 84, at 52.

106. See 12 C.F.R. § 211.1(a) (1994) (setting forth the purpose of this sub-part which is to set out rules governing the international and foreign activities of U.S. banking organizations).

107. The Federal Reserve Act of 1913 required national banks to become members of the Federal Reserve System. 12 U.S.C. § 221 (1992).

108. See *supra* note 107 and *infra* notes 109-113 and accompanying text (discussing requirements and regulations for U.S. banks establishing branches abroad).

109. 12 U.S.C. §§ 347.3, 601 (1992).

110. See 12 C.F.R. § 211 (1994) (authorizing international banking opportunities). This section of the Code of Federal Regulations is also referred to as Regulation K. *Id.*

111. *Id.* § 211.3(a)(2).

112. 12 U.S.C. § 604(a) (1992) (authorizing and restricting branches to act "within the business of banking"). This provision is analogous to Section 24(7) which also authorizes and restricts banks domestically to only engage in those activities which are explicitly authorized and those which are "incidental powers as shall be necessary to carry on the business of banking." *Id.* § 24(7). Explicitly authorized activities include: (1) discounting and negotiating promissory notes, drafts and bills of exchange; (2) receiving deposits; (3) buying and selling currency; (4) loaning money on personal security, and; (5) obtaining, issuing and circulating notes. *Id.* The "business of banking" in the international context seems more permissible and broader than in the domestic context. See *Arnold Tours, Inc. v. Camp*, 472 F.2d 427 (1st Cir. 1972) (defining the "business of banking" as that which is "convenient or useful" to one of the established banking activities pursuant to 12 U.S.C. § 24); *M&M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377 (9th Cir. 1977), *cert. denied* 436 U.S. 956 (1978) (including the leasing of personal and real property in the "business of banking"); *Nat'l Retailers Corp. of Arizona v. Valley Nat'l Bank*, 411 F.Supp. 308 (D. Ariz. 1976), *aff'd.*, 604 F.2d 32 (9th Cir. 1979) (disallowing banks to engage in data processing retailing); *Saxon v. Georgia Ass'n of Indep. Ins. Agents, Inc.*, 399 F.2d 1010 (5th Cir. 1968) (prohibiting banks from acting as insurance brokers in cities with more than 5000 in population); *Republic Nat'l Bank of Dallas v. Northwest Nat'l Bank of Fort Worth*, 578 S.W.2d 109 (Tex. 1978) (allowing banks to issue letters of credit but disallowing banks from offering guaranties); see also 12 U.S.C. § 29 (1992) (establishing a general presumption against banks purchasing, holding or selling real property).

activities than they may engage in domestically. For example, foreign branches may underwrite, sell, or distribute foreign government securities because the Glass-Steagall Act does not apply to foreign banking activities.<sup>113</sup>

Commentators believe that the Fed's control over most foreign banking activity, coupled with its lack of diversity in supervision, eliminates meaningful choices about what banking activities in which to initiate and stifles competition with other countries that have fewer restrictions from their home countries.<sup>114</sup> However, the countervailing argument is that regulation is needed to protect the safety and soundness of U.S. banking institutions, a value which should not be compromised when a U.S. bank goes abroad.

## 2. The Comptroller of the Currency

While the Fed grants permission to open foreign branches, the Comptroller regulates the capital requirements of these branches.<sup>115</sup> In the United States, the Comptroller charts and serves as the primary regulator of U.S. banks; however in regard to U.S. banks abroad the Comptroller confines itself to examining banks' foreign branches and subsidiaries in their capital, and other regulatory requirements.<sup>116</sup> All foreign branches must maintain reserve requirements on transaction accounts and time deposits equal to those held by domestic

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113. See 12 C.F.R. § 211.5 (1994) (setting forth permissible investment activities abroad). The Fed attempts to regulate and control foreign branches just as the Comptroller attempts to regulate national banks in the United States. 12 U.S.C. § 601 (1992). However, foreign banks are immune from Glass-Steagall securities underwriting and selling restrictions so long as they are securities of the foreign government. 12 C.F.R. § 211.5 (1994). Sections 16, 20, 21 and 32 of the Banking Act of 1933 became known as the Glass-Steagall "Wall" because the Act prevented commercial banks from underwriting, selling, or distributing securities and prevented securities firms and brokerage organizations from receiving deposits. See 12 U.S.C. § 24(7) (1992) (prohibiting domestic banks from underwriting or issuing securities); *id.* at § 377 (imposing a penalty not exceeding \$1000 per day for each day a bank engages in the selling or underwriting of securities); *id.* at § 378 (preventing any corporation or similar organization from receiving deposits while underwriting or selling securities at the same time); *id.* at § 78 (prohibiting an officer or director of a bank from engaging in the underwriting or distribution of securities).

114. See Glidden, *supra* note 81, at 110. Of approximately 15,000 commercial banks in the U.S., only 200 have any overseas branches or subsidiaries. *Id.* About 25 of the member banks account for most of the foreign banking activity and assets. *Id.* See also Staff of House Committee on Banking, Finance and Urban Affairs, 101st Cong., 2d Sess., *An International Comparison of Banking Regulatory Structures*, COMM. PRINT 101-3 (June 1990) (setting forth the proposition that liberal banking regulations in other countries put the U.S. banking industry at a disadvantage in the international arena). The reason that few U.S. banks establish branches abroad is the struggle they face against dual regulatory provisions of the United States and another country. Marilyn B. Cane & David A. Barclay, *Competitive Inequality: American Banking in the International Arena*, 13 B.C. INT'L & COMP. L. REV. 273 (1990).

115. The Comptroller of the Currency has principal supervisory authority over national banks. MACEY & MILLER, *supra* note 84, at 61.

116. See 12 U.S.C. § 602 (1992) (promulgating the Comptroller of the Currency as the examiner of all national banks engaging in foreign banking activity). See generally COMPTROLLER'S HANDBOOK FOR NATIONAL EXAMINERS, INTERNATIONAL §§ 800 et seq. (1988) [hereinafter COMPTROLLER'S HANDBOOK].

branches.<sup>117</sup> The Comptroller evaluates a bank's liquidity position by reference to many factors including deposit volatility, ability to convert assets into cash, management expertise, reliance on interest sensitive funds and access to money markets.<sup>118</sup> To determine a bank's capital adequacy, the Comptroller considers subjective criteria such as growth history, plans for future growth, and the strength of the bank's management.<sup>119</sup> Regulators analyze recent earning trends and dividend payout ratios to determine whether and to what extent retained earnings will contribute to future growth capital.<sup>120</sup>

The Comptroller also monitors exchange activities by requiring that national banks file a consolidated report of foreign exchange activities for any month in which specified foreign exchange transactions exceed one billion U.S. dollars.<sup>121</sup> Close regulation of U.S. branch capital requirements ensures branch stability and protects U.S. banking integrity abroad.<sup>122</sup>

### *3. The Federal Deposit Insurance Corporation*

Generally, the FDIC requires domestic banks to keep minimum cash reserve assets in exchange for insuring depositors.<sup>123</sup> Although the FDIC insurance technically does not cover foreign branch deposits if the deposit is recorded and payable only at the foreign branch,<sup>124</sup> the FDIC has traditionally extended coverage to such deposits where the foreign bank became insolvent.<sup>125</sup> Moreover, the FDIC does play a significant role in foreign branch activity by regulating the international activities of state nonmember banks.<sup>126</sup>

State chartered banks that are not members of the Fed derive their powers from the laws of the chartering state. Yet, the banks must seek approval from the

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117. National and state chartered Fed members must have capital and surplus in excess of US\$1 million in order to apply to the Fed for permission to open foreign branches. *See* MACEY & MILLER, *supra* note 84, at 708.

118. *See generally* COMPTROLLER'S HANDBOOK, *supra* note 116, §§ 203, 301, 405, 503, 600 (setting forth supervisory guidelines for liquidity regulation).

119. Cane & Barclay, *supra* note 114, at 277.

120. *Id.*

121. 12 C.F.R. § 20.5(a), (c) (1994). A monthly report must be filed for every month a foreign branch's total currency assets, liabilities, and foreign exchange contracts bought and sold equals or exceeds US\$100 million. *Id.*

122. *See* Corrigan, *supra* note 93, at 68 (discussing the "specialness" of banks and the need for regulation to ensure safety and soundness).

123. 12 U.S.C. § 1813 (1992).

124. *Id.* § 1813(m)(2).

125. *See id.* § 1813(m)(1) (excluding foreign branch deposits from insurance coverage). The Federal Reserve has advised member banks against guaranteeing foreign branch deposits. 12 C.F.R. § 204.112(c) (1994). *See* Chuidian v. Philippine Nat'l. Bank, 976 F.2d 561 (9th Cir. 1992) (limiting the potential liability of U.S. banks operating abroad as paying agents on international letters of credit); *cf.* MACEY & MILLER, *supra* note 84, at 716 (stating that the FDIC will usually cover foreign deposits, even though premiums are not paid, when the bank becomes insolvent).

126. MACEY & MILLER, *supra* note 84, at 708.

FDIC to establish a branch abroad.<sup>127</sup> The FDIC<sup>128</sup> controls state banks which are nonmembers of the Fed maintaining an overseas presence.<sup>129</sup> The state nonmember bank application procedure requires three main steps.<sup>130</sup> First, the state bank must apply to and obtain the FDIC's prior written consent to establish foreign branches.<sup>131</sup> Second, the nonmember bank must then File the application with the appropriate regional director not more than thirty days before opening the branch.<sup>132</sup> Third, the application must state the exact location of the branch and the newspaper in which notice will be published.<sup>133</sup>

### C. Regulations Promulgated Abroad

Both U.S. regulations pertaining specifically to foreign operations and Russian Federation regulations pertaining to foreign branches operating within the country constrain U.S. banks abroad by limiting the types of activities in which they may engage.

#### 1. Russian Federation Commercial and Trade Laws

The Russian Federation has its own, newly created banking regulations for foreigners in its collection of trade and commercial laws.<sup>134</sup> Significantly, the government of the Russian Federation declares that banks in the Russian Federation shall be independent from the bodies of governmental power.<sup>135</sup> This implies a transformation from centralized economic control to a free market eco-

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127. *Id.*; see Glidden, *supra* note 81, at 108 (discussing the regulatory framework for U.S. banks which establish branches abroad).

128. See MACEY & MILLER, *supra* note 84, at 61 (defining the Federal Deposit Insurance Corporation as a bank regulatory agency which is an independent agency headed by a five-person board). Through the Bank Insurance Fund, the FDIC provides deposit insurance to all national banks and almost all state-chartered banks. *Id.*

129. See 12 C.F.R. § 347.1 (1994) (setting forth the scope of this sub-part which is to prescribe regulations relating to foreign branches of insured State nonmember banks); MACEY & MILLER, *supra* note 84, at 708 (defining the Federal Deposit Insurance Corporation as an agency which regulates the international banking activities of state nonmember banks). However, only a small amount of international banking occurs in state nonmember banks. *Id.*

130. 12 C.F.R. § 347.3(a) (1994) (requiring an insured State nonmember bank to apply to the FDIC for permission to establish a foreign branch).

131. *Id.*

132. *Id.*

133. *Id.*

134. COMMERCIAL LAWS, *supra* note 91, arts. 3-5. Banks may establish joint ventures and other associations so long as they do not contradict antimonopolistic legislation. *Id.* art. 3. Foreign banks and branches are regulated by this law and other legislative acts of the Russian Federation. *Id.* art. 4. Banks are prohibited from engaging in manufacture, trade or insurance sale. *Id.* art. 5.

135. See Hill & Slavinski, *supra* note 2, at 4 (describing how over the past two years the Russian Federation has taken significant steps toward private ownership).

nomy.<sup>136</sup> Recently, a group of Russian Federation commercial banks founded the Development and Project Financing Bank (Financing Bank).<sup>137</sup> The Russian Federation commercial bank leaders designed the Foreign Bank to cooperate with Western banks and international financial institutions to raise capital and issue bonds for privatization projects and export projects.<sup>138</sup>

The establishment of banks in the Russian Federation may be based upon any form of ownership, domestic or foreign, as provided for by legislation of the Russian Federation.<sup>139</sup> The Bank of Russia (Central Bank) regulates foreign banks and branches of foreign banks.<sup>140</sup> The Central Bank issues licenses to banks in the Russian Federation.<sup>141</sup>

In order to obtain a license, foreign banks must provide proof of their own country's approval, written consent to establish a foreign bank,<sup>142</sup> and by-laws and other documents verifying their status as a legal person,<sup>143</sup> as well as an application for granting a license, an economic report and information regarding the officials of the bank.<sup>144</sup>

The Russian Federation accepts foreign banking business as demonstrated by the Russian Central Bank's willingness to grant general and offshore licenses to foreign banks.<sup>145</sup> General licenses permit a foreign bank to engage in a full range

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136. COMMERCIAL LAWS, *supra* note 91, art. 8. Employees of government and management are prohibited from participating in the management of banks in conjunction with their other role as a government employee. *Id.*

137. *New Russian Financial Entities Aim To Boost Foreign Investment*, Int'l Fin. Daily (BNA), Mar. 24, 1992, available in WESTLAW, Bna-ibbd Database.

138. *Id.*

139. COMMERCIAL LAWS, *supra* note 91, art. 1. Commercial banks may be established with foreign capital. *Id.*

140. *Id.* art. 4.

141. *Id.* art. 1. See also *Russian Central Bank Tightens Rules Governing Foreign Banking Activities*, Banking Daily (BNA), May 7, 1993, available in WESTLAW, Bna-bbd Database (setting forth stricter licensing and capital requirements as promulgated by the Central Bank); *Yeltsin Decree Will Bar Some Foreign Banks From Servicing Russian Residents Until 1996*, Banking Daily (BNA), Nov. 22, 1993, available in WESTLAW, Bna-bbd Database (describing Yeltsin's moratorium on foreign banks which registered for a license in the Russian Federation after November 15, 1993). If the foreign bank had started to serve Russian Federation clients then it would be exempted from the moratorium. *Id.* *Russia to Ease Restrictions on Operations of Foreign Banks*, Banking Daily (BNA), June 1, 1994, available in WESTLAW, Bna-bbd Database (establishing additional exceptions to the November 1993 moratorium so that a number of foreign banks will be allowed to operate).

142. See *supra* notes 94-133 and accompanying text (discussing Fed approval for national banks and FDIC approval for non-Fed member state chartered banks).

143. COMMERCIAL LAWS, *supra* note 91, art. 13.

144. *Id.* art. 12.

145. See *New Opportunities Emerging For Foreign Banks in Russia*, *supra* note 23. On February 12, 1993, the Russian Central Bank signed a "protocol of intent" with France's *Banque Nationale de Paris* and Germany's *Dresdner Bank* to open a jointly owned subsidiary in St. Petersburg. *Id.* As of September 22, 1993, six foreign bank subsidiaries were granted general banking licenses. *Credit Suisse and ING Go Russian Intends to Open Branch in Moscow, Russia*, COMMERSANT, Sept. 22, 1993, available in WESTLAW, Pts-prompt Database.

of banking activities<sup>146</sup> in rubles<sup>147</sup> and hard-currency.<sup>148</sup> A limited offshore license allows a bank to open a branch in the Russian Federation, and authorizes it to provide hard-currency banking services only for foreigners and Russian Federation organizations authorized by the government to keep funds in foreign banks.<sup>149</sup> Although a branch which is granted a limited license does not need to meet the same capital requirements as domestic commercial banks, it is not considered a separate legal entity under Russian Federation law and is not afforded the protection of Russian Federation laws.<sup>150</sup> While a general license may be more favorable, limited licenses are granted more frequently.<sup>151</sup>

Permissible banking operations with a general license include normal functions such as: (1) receiving deposits; (2) maintaining accounts; (3) issuing, buying, and selling negotiable instruments; (4) making loans; (5) functioning as sureties and guarantors; (6) acquiring the rights of demand with respect to supply of goods and performance of services; (7) acquiring from and selling to Soviet, foreign legal, and natural persons currency in cash or in accounts; (8) acquiring and selling, in and out of the Russian Federation, precious metals, gems and jewelry as well as deposit precious metals; (9) managing securities by trust; (10) performing brokerage, consulting and leasing operations; and (11) performing other operations and transactions in accordance with permission of the Bank of Russia to be issued within the scope of its competence.<sup>152</sup>

Having obtained the appropriate license, banking operations may be performed in rubles as well as in hard currency.<sup>153</sup> The authority of the Bank of Russia mandates supervision of banks and action upon regulation violations.<sup>154</sup>

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146. See COMMERCIAL LAWS, *supra* note 91, art. 5 (outlining Russian Federation banking activities).

147. A ruble is the monetary unit of the former Soviet Union. WEBSTER'S NEW WORLD DICTIONARY 514 (1990).

148. See *New Opportunities Emerging For Foreign Banks in Russia*, *supra* note 23. Because of the political climate in the Russian Federation at this time and the unwillingness of newly created commercial banks to compete with foreign banks, few general licenses are granted. *Id.* Most general licenses are granted to foreign bank subsidiaries which must meet the same US\$178,000 capital requirement as domestic banks. *Id.*

149. *Id.* In late 1992, Bank Austria was granted a limited offshore license and then opened the first branch of a foreign bank in the Russian Federation. *Id.*

150. *Id.*

151. *Id.*

152. COMMERCIAL LAWS, *supra* note 91, art. 5.

153. *Id.* art. 5.

154. *Id.* art. 33. Supervisory actions may include: (1) taking measures to improve the bank's financial state, including increases of its capital and modification of the structure of assets; (2) reorganization of the bank; (3) replacement of management; and (4) liquidating the bank. *Id.* Supervisory control mechanisms for more minor violations include exacting fines, raising the statutory reserve rate, appointing interim administration, and revoking the license. *Id.*

## 2. The International Monetary Fund

The practitioner must also consider international influences which set regulatory guidelines for the Russian Federation economy. The International Monetary Fund (IMF),<sup>155</sup> of which both the United States and the Russian Federation are members, has its own set of monetary regulations and guidelines that direct all of its members.<sup>156</sup> Financial aid is given in exchange for compliance with IMF regulations and guidelines.<sup>157</sup> The Russian Federation's government recently promised to follow a tight monetary policy and move toward ruble convertability in a memorandum to the IMF.<sup>158</sup> The impact of this is a stronger economy and ruble exchangeability with hard currency.

### D. Federal Court Jurisdiction Over International Banking Transactions

The practitioner should understand remedies which may be afforded to Russian Federation citizens who bring suit against a foreign branch. Litigants may utilize the federal courts under Section 632 of the Glass-Steagall Act<sup>159</sup> in a lawsuit where the nationally chartered corporation is a party and the subject matter arises from transactions involving foreign banking.<sup>160</sup>

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155. See MACEY & MILLER, *supra* note 84, at 711 (describing financial assistance that is available for international banking activities). The IMF has played an influential role in persuading foreign governments, to which the IMF has given large loans, to improve their social and economic domestic systems. *Id.*

156. See Steven Greenhouse, *Lending Agencies Admit Ex-Soviets As Full Members*, N.Y. TIMES, Apr. 28, 1992, sec. A, at 1, available in LEXIS, News Library, Majpap File. The Russian Federation, Ukraine and other former Soviet Republics were offered membership to the IMF and the World Bank in April 1992. *Id.* Membership was made contingent upon the Russian Federation's promise to reduce the budget deficit, curb growth in the money supply to bring inflation under control, establish a legal framework and contractual rights, reform farming and energy, develop a solid fiscal system which will enable the government to meet international obligations, and establish a single rate for the ruble. *Id.* Cf. Fred Hiatt, *Historic Chance to Aid Ailing Russia Said to Be Slipping Away*, WASH. POST, Mar. 1, 1993, § 1, at A1, available in LEXIS, News Library, Majpap File. Western experts say that given the Russian Federation's political and economic stability, traditional aid such as that of the IMF is likely to be wasted and counterproductive. *Id.*

157. The World Bank has approved US\$200 million in co-financing which will assist commercial banking services in the Russian Federation by establishing a core group of 30-40 private commercial banks and a private clearing system at the federal level. *World Bank Finance for Russian Banks*, INT'L TRADE FIN., June 3, 1994, available in WESTLAW, Pts-promt Database. This project is cofinanced with a US\$100 million line of credit to Russian banks from the European Bank for Reconstruction and Development. *EBRD Agrees to \$100 Million Credit Line to Benefit Private Enterprises in Russia*, INT'L BUS. & FIN. DAILY (BNA) Sept. 27, 1994, available in WESTLAW, Bna-ibfd Database. The creditline will enable Russian Federation banks to provide working capital for the restructuring of plants and assist in the diversification of product lines. *Id.*

158. See *New Russian Financial Entities Aim To Beat Foreign Investment*, INT'L FIN. DAILY (BNA), Mar. 24, 1992, available in WESTLAW, Bna-ibbd Database (indicating that the IMF conditioned several billion U.S. dollars in assistance on the Russian Federation's promise of economic reform.)

159. 12 U.S.C. § 632 (1994).

160. Robert M. Brill & James J. Bjorkman, *Federal Court Jurisdiction Over International Banking Transactions*, 110 BANKING L.J. 118 (1993).

Under two identifiable judicially recognized approaches to the problem, consisting of a narrow and broad interpretation of the Glass-Steagall Act, there are three primary limitations on Section 632: (1) one of the parties to the suit must be a corporation organized under the laws of the United States; (2) the transaction must involve traditional banking activities; and (3) those banking activities must be connected in some way to international or foreign banking, or to the operation of foreign branches, agencies, local institutions of a national corporation, or banking territory of the United States.<sup>161</sup> For the most part, Section 632 has been construed narrowly; however, one U.S. District Court specifically found that Section 632 expanded the jurisdiction of federal courts to all national banks, as well as branches under the Edge Act.<sup>162</sup> Thus, the practitioner can anticipate that grievances of those who bank at U.S. branches and subsidiaries abroad may be addressed in U.S. courts.

#### IV. ANALYSIS AND RECOMMENDATIONS

Despite any uncertainties which may surround the legal structure and economic climate of the Russian Federation, U.S. banking practitioners may successfully guide their clients with careful and cautious planning.<sup>163</sup>

The practitioner who advises bankers will optimistically note the need for U.S. banks to follow businesses into the Russian Federation and at the same time be aware of legal ramifications which may precipitate as a result of changes in the political and economic climate.<sup>164</sup>

Mixed public sentiment towards the U.S. infusion into Russian economics exists among Russian Federation citizens.<sup>165</sup> Using the West as a scapegoat seems to be the local reaction to high inflation, unattainable consumer goods and the strong presence of organized crime.<sup>166</sup> Moreover, the collapse of recent U.S. business ventures in the Russian Federation illustrates that the Russian Federation's

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161. See *Telecredit Serv. Ctr. v. First Nat'l Bank of the Florida Keys*, 679 F.Supp. 1101 (S.D. Fla. 1988) (interpreting § 632 as having a very narrow scope); see also *Corporacion Venezolans de Fomento v. Vintero Sales Corp.*, 629 F.2d 786 (2d Cir. 1980), *cert. denied*, 449 U.S. 1080 (1981) (recognizing the narrow scope of § 632 but permitting a large number of cases to be brought under § 632). A broader meaning, based on the "plain meaning" of § 632 can be seen in two recent cases. See *Sullivan v. Everhart*, 494 U.S. 83, 89 (1990); *Pavelic & LeFlore v. Marvel Entertainment Group*, 493 U.S. 120, 123 (1989).

162. *Corporacion Venezolana de Fomento*, *supra* note 161, at 786; *cert. denied*, 449 U.S. 1080 (1981) (recognizing the narrow scope of § 632 but permitting a large number of cases to be brought under § 632).

163. See Birenbaum, *supra* note 1, § 2.01 (asserting that despite the uncertainty, there is opportunity to profit in newly emerging market economies).

164. *Id.*

165. See *New Opportunities Emerging for Foreign Banks in Russia*, *supra* note 23 (asserting that Russian Federation bankers are strongly opposed to foreign banks in the domestic market because of the increased competition); see also Max Wyman, *The Bleak Smile of Emerging Russia*, OTTAWA CITIZEN, Oct. 29, 1994, at B3, available in LEXIS, News Library, Majpap File (observing a Russian student's reaction to the growing economic chaos).

166. See Wyman, *supra* note 165, at B3.



recent political unrest and the cost of doing business make the banking market very risky.<sup>167</sup>

The strong presence of the Russian mafia undermines the emerging economy, and may create adverse legal ramifications for foreign investors.<sup>168</sup> Organized crime controlled as much as forty percent of the turnover of goods and services by 1993.<sup>169</sup> Recent figures indicate that the mafia of the Russian Federation controls eighty percent of the Russian Federation Gross National Product (GNP).<sup>170</sup> A government investigation revealed that over half of the Russian Federation criminal groups in 1992 had ties to the government.<sup>171</sup> Many of the wealthy elites from the Soviet regime became part of organized crime when the government collapsed.<sup>172</sup> Due to the recent discovery of an attempted swindle by mobsters inspired by senior Finance Ministry officials, officials suspect that the mafia is not only trying to profit from banks but also trying to indirectly control politics by undercutting private commercial banking activities.<sup>173</sup>

Political disruption among the various ethnicities of the Russian Federation is another obstacle facing foreign investors. Recent political unrest in the Russian Federation may thwart economic reform and make U.S. banking in the Russian Federation impossible.<sup>174</sup> Economic aid and cooperation is often used as leverage

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167. Wade Lambert, *Risks of Doing Business in Russia are Reflected in Venture's Failure*, WALL ST. J., Apr. 13, 1994, § B, at 5. A New York law firm, Kenyon & Kenyon, attempted and failed to market inventions by Russian Federation scientists. *Id.*

168. Top bank officials contend that many bankers are involved in money laundering and organized crime yet little has been done to resolve the problem. *Commercial Banks on the Rise*, FIN. E. EUR., July 1, 1994, available in WESTLAW, Pts-prompt Database; see Stephen Handelman, *The Russian Mafia*, 73 FOREIGN AFF. 83 (1994) (defining and explaining the presence of the mafia in the Russian Federation).

169. See Handelman, *supra* note 168, at 84 (reporting mafia control of goods and services, according to the Russian Federation Ministry of Internal Affairs). Between 3000 and 4000 gangs operate in the Russian Federation, several hundred of which also operate within the Commonwealth of the Independent States. *Id.* at 83.

170. Wyman, *supra* note 165, at B3.

171. Handelman, *supra* note 168, at 84.

172. See *id.* "Mounting evidence indicates that nomenklatura capitalists use organized crime groups as instruments in the fierce struggle over the spoils of the former Soviet Union: the industries, banks, defense facilities, ports and factories once exclusively controlled by the Communist Party." *Id.*

173. *Id.* The mobsters attempted to swindle \$350 million U.S. dollars, through the use of promissory notes, from private banks in Moscow. *Id.*

174. The region of Chechnya in the Russian Federation is fighting for independence; thousands have been killed as the Russian Federation army has attempted to squelch the rebellion. See Elaine Sciolino, *U.S. and Russia At Odds, Despite Talks*, N.Y. TIMES, Jan. 19, 1995, § A, at 6; Fred Kaplan, *Yeltsin Scraps Cease-Fire Plan; Both Sides Continue Fighting*, HOUS. CHRON., Jan. 19, 1995, available in LEXIS, News Library, Majpap File (stating Yeltsin's belief that the leaders of Chechnya are committing mass genocide and need to be stopped); Ken Montaigne, *West Faces Dilemma On Withholding Russian Aid*, PHILADELPHIA INQUIRER, Jan. 19, 1995, § A, at 1, available in LEXIS, News Library, Majpap File (describing the concern of economists and legislators that the war in Chechnya may thwart economic reform and prevent the West from giving promised aid); Steve Liesman, *Russia Investors Find Exit Doors Locked*, WALL ST. J., Jan. 19, 1995, § A, at 1 (reporting illiquidity resulting from the war in Chechnya is preventing investor's in the Russian Federation stock market from selling their holdings, signaling a fragile market).

in political struggles between U.S. leaders and Russian Federation leaders which could mean an uncertain and unstable market for U.S. bankers operating in the Russian Federation.<sup>175</sup>

The concern for practitioners and bankers is that a serious political disagreement will cause adverse economic foreign relations and changes in laws conducive to U.S. activities in the Russian Federation.<sup>176</sup> However, the U.S. government has invested a significant amount, economically and politically, in good relations with the Russian Federation; it is unlikely that the Chechnya rebellion controversy will materialize into a serious rift between the U.S. and the Russian Federation.<sup>177</sup>

Although legal uncertainty exists with the change of any country's leadership, the fact that the U.S. government and the IMF continue to invest billions of dollars in assistance to the Russian Federation is an optimistic sign that continued reform is anticipated.<sup>178</sup> The practitioner should regard cooperation of the Russian Federation with the United States and IMF leaders as an indication of economic and legal stability.

Both U.S. leaders and Russian Federation leaders seem to agree that economic coordination and cooperation is needed. At a 1992 Russian Summit, the Russian Federation and the United States agreed that the promotion and development of free markets, economic recovery and growth, and closer cooperative economic trade and investment are essential to both the stability of the Russian Federation and the Russian Federation's relationship with the United States.<sup>179</sup> The Russian Federation's long-term prosperity is contingent upon the continuation of the present path of free market reform.<sup>180</sup> Also, the Russian Federation's economic revival and integration into the global economy depends upon the

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175. See *supra* note 172 (discussing mafia control over goods and services in the domestic Russian Federation market); Lee Michael Katz, *A 20-Questions Policy Session*, U.S.A. TODAY, Jan. 19, 1995, at 9A (setting forth a fundamental debate between the United States and Russian Federation leaders about whether the Russian Federation should continue its suppression of the Chechnya rebellion). The U.S. leaders express concern that the Russian Federation will become entrenched in a military quagmire which depletes the economy. Jim Mann, *Christopher Promises Further Aid For Russia; Diplomacy: Secretary of State Criticizes Chechnya War But Says No 'Cold Peace' Will Divide Nations*, L.A. TIMES, Jan. 19, 1995, at A9. At the same time, however, U.S. Secretary of State Warren Christopher has explicitly indicated that the U.S. would like to continue aiding the Russian Federation. *Id.*; cf. Kaplan *supra* note 174 at A15. United States leaders have also threatened unfavorable economic consequences if the Russian Federation continues its fight with Chechnya. *Id.*

176. See *supra* note 174.

177. See *supra* note 175.

178. See *supra* notes 155-158 (discussing how the IMF is giving financial assistance to the Russian Federation contingent upon continued economic reform in the Russian Federation).

179. See DISPATCH, *supra* note 1 (setting forth the need for communication and cooperation between the United States and Russia in order to build a stable and sound market economy); see also *Governing Activities of Foreign Banks*, *supra* note 20 (asserting that some top banking officials believe foreign banking presence is essential to the success of the Russian Federation banking system).

180. *Id.*

critical role played by the private sector because the West advocates free market progression.<sup>181</sup>

The need for a favorable investment climate in the Russian Federation has led Russian Federation leaders to create mutually beneficial Russian Federation-American cooperation in trade, investment, and business promotion.<sup>182</sup> Economic cooperation is crucial to banking law because the success of U.S. branches operating in the Russian Federation is contingent upon political relations between the countries.<sup>183</sup>

The newly implemented free market economy is still in its early stages which leaves opportunity for foreign businesses to establish strong ties and influence in the Russian Federation.<sup>184</sup> Although some uncertainties surround banking opportunities, the practitioner must remember that the banking business is the most profitable business in the Russian Federation.<sup>185</sup> U.S. banks that venture into the Russian Federation now will position themselves well for the future as the Russian Federation economy strengthens and expands.<sup>186</sup>

## V. CONCLUSION

The United States has an historic opportunity to aid the Russian Federation in its transition into a free market economy.<sup>187</sup> The banking system is a key component for Russian Federation economic success. The U.S. banking industry should capture the opportunity to play an influential role by expanding banking operations to the Russian Federation.<sup>188</sup>

There are two predominant and distinct ways in which U.S. banks may branch out to the Russian Federation. U.S. bank branches, subject to federal banking regulations, may be established in the Russian Federation.<sup>189</sup> Edge branches or subsidiaries engaged in the banking business, subject to federal

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181. *Id.*

182. *Id.*

183. *Id.*; see Montaigne, *supra* note 174, § A (discussing the fears of Russian Federation economists and legislators that the war with Chechnya will thwart economic reform in the Russian Federation and cooperation with the West).

184. See *supra* notes 30-38 and accompanying text (showing that the Russian Federation seeks western investment in newly forming business ventures).

185. Lapidus & Corbin, *supra* note 17, at 25. In the Russian Federation stock exchange, commercial bank stocks are highly valued. Banks have started to issue shares in hard currency with an annual yield of 8-10%. *Id.* One reason why commercial banks are valuable businesses in the Russian Federation is because they are so few in number compared to the population. *Id.*

186. *Id.* United States and European businesses are steadily increasing their presence in the Russian Federation. *Id.* Foreign capital now accounts for 5% of the total capital of Russian Federation banks. *Id.* There is a great need for modern management, raw materials and secondary resources in the Russian Federation, markets which will not become saturated for many years. *Id.*

187. See *supra* notes 1-11 and accompanying text.

188. See *supra* notes 16-38 and accompanying text.

189. See *supra* notes 73-80 and accompanying text.

banking regulations, may also be established in the Russian Federation.<sup>190</sup> Both bank branches and Edge subsidiaries have great investment potential.

The practitioner must contend with both U.S. and Russian Federation regulations.<sup>191</sup> The U.S. regulations are predominantly enforced by the Fed but the FDIC authorizes state chartered banks to establish branches abroad and the Comptroller is primarily responsible for monitoring the liquidity and capital requirements.<sup>192</sup>

The Russian Federation has its own set of banking laws derived from its Commercial and Trade Laws.<sup>193</sup> The Central Bank primarily regulates the foreign branches.<sup>194</sup> The practitioner will find that the U.S. regulations are more extensive than those of the Russian Federation.<sup>195</sup> However, the primary impediment of the Russian Federation laws is that a general license must be obtained from the Central Bank to engage in all banking activities.<sup>196</sup> Most licenses granted at this stage are "limited," meaning that foreign banks are limited to banking with nonresidents of the Russian Federation.<sup>197</sup> General licenses will be granted more often as Russian Federation banks become more competitive.<sup>198</sup>

The practitioner must also monitor the activities of the IMF.<sup>199</sup> So long as financial funding is granted to the Russian Federation, economic reform and legal stability are almost certain because the funding is contingent upon economic reform and compliance with western standards.<sup>200</sup> In addition, the practitioner should keep in mind that grievances of foreigners, who bank with U.S. branches, may be addressed in U.S. federal courts.<sup>201</sup> Regardless of the type of enforcement abroad, bankers should be mindful of the need to keep adequate capital requirements to protect foreign clients.<sup>202</sup>

One obstacle which the practitioner must be aware of includes internal political unrest such as the increasingly dominant presence of the mafia in the Russian Federation, which may have potential legal ramifications.<sup>203</sup> Although there has been an infiltration of mafia members into the banking industry and government, it seems as though this problem will correct itself as the new government strengthens, democratic roles become more certain, and the economy improves.

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190. See *supra* notes 81-91 and accompanying text.

191. See *supra* notes 92-154 and accompanying text.

192. See *supra* notes 92-133 and accompanying text.

193. See *supra* notes 134-154 and accompanying text.

194. See *supra* notes 140-141 and accompanying text.

195. See *supra* notes 92-133 and accompanying text.

196. See *supra* notes 139-151 and accompanying text.

197. See *supra* notes 149-151 and accompanying text.

198. See *supra* note 151 and accompanying text.

199. See *supra* notes 155-158 and accompanying text.

200. See *supra* notes 157-158 and accompanying text.

201. See *supra* notes 159-162 and accompanying text.

202. See *supra* notes 115-122 and accompanying text.

203. See *supra* notes 168-173 and accompanying text.

Another obstacle of which the practitioner must be aware is the Chechnya rebellion which may lead to strained U.S.-Russian Federation relations.<sup>204</sup> However, it seems as though the United States views cooperation with the Russian Federation government as a higher priority than trying to deter the Russian Federation from violently suppressing the rebellion.<sup>205</sup> Although obstacles may impede U.S. banks operating in the Russian Federation, such obstacles can be regarded as growing pains which will lessen with time.

Overall, investment opportunities for U.S. banks establishing branches in the Russian Federation are clearly present. So long as the Russian Federation government continues to reform and establish a solid legal foundation, an excellent opportunity exists for U.S. banks and businesses to venture into the Russian Federation.

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204. *See supra* notes 174-177 and accompanying text.

205. *See supra* note 174 and accompanying text.

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